91-997

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF WHITE FARM EQUIPMENT COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition For Writ Of Certiorari To The United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether the scheme of the Bankruptcy Code as intended by Congress, which provides for the discharge of all claims of a corporate debtor under a confirmed plan of reorganization, can be overturned in favor of the collection of taxes.

Whether the provisions of 11 U.S.C. §1141(d)(1), providing for the discharge of all pre-petition debts of a corporation as a result of the confirmation of a Chapter 11 reorganization plan, discharges a tax claim treated pursuant to 11 U.S.C. §1129(a)(9)(C), causing such tax claim to become an unsecured claim in a serial Chapter 11 case.

PARTIES TO THE PROCEEDING

The parties to the proceedings in the courts below were White Farm Equipment Company, the debtor in bankruptcy; the Official Committee of Unsecured Creditors of White Farm Equipment Company, petitioner; and the United States, respondent, on behalf of the Internal Revenue Service.

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PETITION FOR WRIT OF CERTIORARI

The Official Committee of Unsecured Creditors of White Farm Equipment Company respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-11a) is reported at 943 F.2d 752. The opinion of the district court (App., *infra*, 12a-19a), which the court of appeals reversed, is reported at 111 Bankr. 158. The opinion of the bankruptcy court (App., *infra*, 20a-30a), which the district court reversed, is reported at 103 Bankr. 177.

JURISDICTION

The judgment of the court of appeals was entered on September 17, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Pertinent sections of the Bankruptcy Code (11 U.S.C. §101 *et seq.*), are as follows:

§ 507. Priorities.

(a) The following expenses and claims have priority in the following order:

* * *

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—

* * *

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

§ 523. Exceptions to discharge.

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

(1) for a tax or a customs duty—

(A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed;

§ 1129. Confirmation of plan.

(a) The court shall confirm a plan only if all of the following requirements are met:

* * *

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

* * *

(C) with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

§ 1141. Effect of confirmation.

* * *

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—

(A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h) or 502(i) of this title, whether or not—

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

STATEMENT

A. The Statutory Scheme

Congress has provided for the discharge of the debts of a debtor which has confirmed a reorganization plan under Chapter 11 of the Bankruptcy Code. 11 U.S.C. §1141(d). Priority claims must be included in the plan of reorganization. 11 U.S.C. §1129(a)(9)(A-C). Withheld payroll taxes (also referred to as "trust fund taxes") are entitled to priority over general unsecured creditors. 11 U.S.C. §507(a)(7)(C). Unless the reorganization plan specifically provides to the contrary, a corporate debtor's trust fund tax obligations are discharged upon confirmation of the plan along with other debts of the corporation. 11 U.S.C. §1141(d)(1)(A). By contrast, the Bankruptcy Code provides that an *individual's* trust fund tax obligations cannot be discharged by inclusion in a reorganization plan. 11 U.S.C. §1141(d)(2) and §523(a)(1)(A).

Inclusion of priority taxes among dischargeable debts covered by a plan of reorganization is consistent with the purpose of Section 1141(d), as described by Representative Edwards of California, who was instrumental in the drafting and enactment of the Bankruptcy Reform Act of 1978; speaking of Section 1141(d), Representative Edwards stated:

> It is necessary for a corporation or partnership undergoing reorganization to be able to present its creditors with a fixed list of liabilities upon which the creditors or third parties can make intelligent decisions. Retaining an exception for discharge with respect to nondischargeable taxes would leave an undesirable uncertainty surrounding reorganizations that is unacceptable.

124 Cong. Rec. 32404; see K. N. Klee, *The Legislative History of the New Bankruptcy Law*, Collier on Bankruptcy, App. Vol. 2, at v-xxix (1979).

B. The Proceedings in This Case

1. On September 4, 1980, White Farm Equipment Company ("WFE") filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The Internal Revenue Service ("IRS") filed a priority claim for tax obligations of the debtor under 11 U.S.C. §507(a).

A plan of reorganization was confirmed on October 31, 1981, which contemplated the ongoing operation of WFE's business and provided for payment of the priority tax claim in equal installments over a six-year period, in accordance with 11 U.S.C. §1129(a)(9)(C).

On May 20, 1985, an involuntary petition to liquidate WFE was filed under Chapter 7 of the Bankruptcy Code, but was soon converted to a voluntary Chapter 11 case. WFE continued to operate its business, and the Official Committee of Unsecured Creditors of WFE, petitioner herein, was appointed by the Office of the United States Trustee. The IRS filed a claim for the same tax obligations, plus interest, since only a fraction of the amount due under the first reorganization plan had been paid. The IRS asserted a right to a seventh priority; petitioner filed a timely objection, contending that once the tax claim had been accorded priority in the first plan, it was thereafter entitled only to be treated as a general unsecured claim in the plan of liquidation confirmed in this case.

2. The bankruptcy court denied petitioner's objection and held that the tax obligation was again entitled to priority status. App., *infra*, 29a.

On appeal by petitioner the district court reversed, holding that the tax claim constituted a general unsecured claim against the second Chapter 11 estate. App., *infra*, 19a. The court relied upon three principal points.

First, the Code treats corporate and individual debtors differently with respect to discharge of past due taxes. Section 523 specifically makes withholding taxes non-dischargeable as to individual debtors, but there is no similar provision as to corporate debtors. Therefore, if Section 1141 does not discharge a corporate debtor from a priority tax debt, just as it does from all other pre-petition debts, Section 523(a) would be meaningless.

Second, the legislative history supports this view. A Senate version of Section 1141(d)(2) would have made priority taxes non-dischargeable with respect to corporate as well as individual debtors. But the House version was adopted, with Representative Edwards explaining the reason (see p. 4, *supra*).

Third, the district court rejected, as contrary to the plain language of the Bankruptcy Code, the IRS argument that tax priority is preserved by a reorganization plan providing for full payment. The court quoted the same bankruptcy judge in a recent decision that had upheld the validity of a second Chapter 11 reorganization case for a debtor:

> The provisions of a confirmed plan bind all parties whose rights are affected by the plan . . . [W]hen, as here, substantial operations under a confirmed plan are followed by a second case, the entity's unpaid liabilities under the first case plan become general unsecured claims in the second case.

In re Jartran, Inc., 76 Bankr. 123, 125 (Bankr. N.D. Ill. 1987).

C. The Court of Appeals Decision

The court of appeals reversed, relying upon its reading of the language of the Bankruptcy Code and upon accom-

modation of the tax collector's interest in raising revenue. It also held that its decision was consistent with legislative history; earlier in its opinion the court had commented that Congress never directly addressed the question presented.

The court rejected petitioner's argument that Congress distinguished between corporate and individual debtors, with Section 1141(d)(1) discharging all debts of a corporation that arose prior to confirmation of a plan, whether or not a claim was filed or allowed, and Sections 1141(d)(2) and 523(a)(1) prohibiting discharge of debts of an individual for certain taxes and custom duties. Paying lip service to the plain language of the statute, the court of appeals construed Section 523 as prohibiting discharge of individual debtors "only for *hidden liabilities*—debts not included in the plan of reorganization because no proof of claim was ever filed." App., *infra*, 7a.

Thus, according to the court of appeals, the only distinction between corporate and individual debtors relates to Section 1141 discharging a corporation's "hidden liabilities"; Section 507 priorities for corporate tax debts would not be discharged.

The court of appeals also rejected petitioner's argument that the bankruptcy court's decision was in direct conflict with its earlier decision which held that administrative claims in a confirmed plan in a first Chapter 11 case did not retain their priority in a second, serial Chapter 11 case for the same debtor. *In re Jartran*, 71 Bankr. 939, *aff'd*, 87 Bankr. 525, *aff'd*, 886 F.2d 859 (7th Cir. 1989); *In re Jartran*, 76 Bankr. 123. The court of appeals agreed that the language of *Jartran* clearly said that when

> substantial operations under a confirmed plan are followed by a second case, the entity's unpaid liabil-

> ities from the first case plan become general unsecured claims in the second case.

76 Bankr. at 125. According to the court of appeals, however, the *Jartran* decision was limited to administrative claims because that is what was involved in the case. App., *infra*, 9a.

REASONS FOR GRANTING THE PETITION

I.

THE COURT OF APPEALS HAS ERRONEOUSLY RESOLVED AN IMPORTANT POINT OF CONFLICT BETWEEN BANKRUPTCY AND TAX POLICY CONTRARY TO THE CLEAR INTENT OF CONGRESS.[1]

In ruling as it has, the court of appeals has elevated the collection of taxes above the bankruptcy scheme established by Congress. The court ignored the warning in the House Report that accompanied the Bankruptcy Reform Act of 1978:

> From an historical perspective, Congress has taken great care to insure that tax policy will not frustrate the operation of bankruptcy.

H.R. Rep. No. 95-595, 95th Cong., 2d Sess. 274, *reprinted in* 1978 U.S. Code Cong. & Admin. News 6231. The Court has recently rejected the IRS' contention that tax-related policy considerations are paramount to the Bankruptcy Code's express provisions and goals. *United States v. Energy Resources, Inc.*, 495 U.S. 545, 110 S.Ct. 2139 (1990).

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[1] The court of appeals acknowledged the "significance of the legal issues involved." App., *infra*, 2a.

In construing the applicable sections of the Bankruptcy Code, the court of appeals should have begun its inquiry with the language prescribed by Congress, and should have ended its inquiry with the plain language of these provisions. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240-41, 109 S.Ct. 1026, 1030-31 (1989); *In re Plaza de Diego Shopping Center, Inc.*, 911 F.2d 820 (1st Cir. 1990). The plain meaning of legislation should be conclusive, unless the intention of the drafters is demonstrably to the contrary. *Ron Pair Enterprises*, 489 U.S. at 242, 109 S.Ct. at 1031.

In this case the bankruptcy court and the court of appeals have rejected Congress' intent to give a corporate debtor in Chapter 11 reorganization a "fresh start" by discharging pre-petition debts that are treated in a confirmed plan of reorganization. In a second reorganization these courts gave the tax collector a second chance at a priority position which had not been accorded the government by Congress. The effort of the courts below to rewrite the applicable provisions of the Bankruptcy Code should not be permitted to stand.

The court of appeals noted that:

> In enacting the Bankruptcy Code, Congress acknowledged the existence of a "three-way tension" among the general creditors' interest in recouping their investment, the debtor's interest in a fresh start unburdened by massive past taxes and the tax collector's interest in raising revenue.

App., *infra*, 7a. However, in its resolution of that "tension" the court misread the Bankruptcy Code and Congressional intent.

In the 1978 reform of the Bankruptcy Code, which was in development for more than eight years, the Senate ver-

sion, S. 2266, provided in Section 1141(d)(2) that in reorganization of a corporate debtor, priority taxes under Section 507 were not dischargeable.[2] However, as described by Representative Edwards, a co-sponsor of the legislation, that proposal was rejected and the House bill was adopted as preferable to the Senate Amendment, for the reasons quoted above. *Supra*, p. 4. Thus, the scheme put in place by Congress provided that priority taxes of a corporate debtor would be discharged under Section 1141(d)(2)—while such taxes of an individual would not—under Section 523(a)(1)(A). If Congress had intended that priority taxes of a *corporate* debtor should not be discharged, it could have made its intent known in the same express manner as it did with respect to *individuals*. *See Sinclair Refining Co. v. Atkinson*, 370 U.S. 195, 204-5, 82 S.Ct. 1328, 1333-34 (1962).

II.

THE COURT OF APPEALS' DECISION IS IN DIRECT CONFLICT WITH THE DECISION IN THE *JARTRAN* CASE.

In *Jartran* the bankruptcy court and the court of appeals established the principle that the Bankruptcy Code permitted serial Chapter 11 reorganization cases. The second reorganization case was not a continuation of the first, but was a separate case "characterized by different objectives, assets and claims." *In re Jartran, Inc.*, 71 Bankr. 939, 941 (Bankr. N.D.Ill. 1987), *aff'd*, 886 F.2d 859 (7th Cir. 1989).

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[2] S.Rep. No. 95-989, 95th Cong., 2d Sess. 129, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5915.

More importantly, the bankruptcy court clearly held that administrative expenses, the first priority under Section 507(a) of the Bankruptcy Code, did not retain their priority from the first reorganization plan to the second. According to the court in its *Jartran* opinion, "unpaid liabilities under the first case plan become general unsecured claims in the second case." 76 Bankr. at 125. This same principle should have been applied to the priority tax claim in this case, but it was not. The court of appeals held that, "absent a clear signal from Congress," the court would not extend the *Jartran* decision beyond its applicability to administrative claims. As shown above, Congress has spoken on the subject by making priority tax claims against a corporate debtor dischargeable upon inclusion in a confirmed plan of reorganization. The court of appeals has ignored the "clear signal from Congress" and assumed the role of legislator.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 13, 1991

APPENDICES

APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 90-1537

IN THE MATTER OF:

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF WHITE FARM EQUIPMENT COMPANY,

Debtor.

APPEAL OF: INTERNAL REVENUE SERVICE

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 89 C 7489—**Harry D. Leinenweber,** *Judge.*

ARGUED JANUARY 16, 1991—DECIDED SEPTEMBER 17, 1991

Before BAUER, *Chief Judge*, WOOD, JR. and CUDAHY, *Circuit Judges.*

CUDAHY, *Circuit Judge.* Two years ago, in *Fruehauf Corp. v. Jartran, Inc.*, 886 F.2d 859, 860 (7th Cir. 1989), we were asked to pass upon "the novel question of the propriety of serial Chapter 11 bankruptcy filings." Although the drafters of the Bankruptcy Code never envisioned a new Chapter 11 petition as a method of liquidation, we held that nothing in the Code precludes serial Chapter 11 filings. Our decision in *Jartran* spawned the interesting, almost metaphysical question that is before us now: whether a tax debt is stripped of its underlying character and transformed into a mere contractual obliga-

tion once it is incorporated in a confirmed plan of reorganization. Specifically, we must determine whether a priority claim for trust fund taxes retains its priority in a second Chapter 11 petition.

I.

Despite the complexity and significance of the legal issues involved, the facts underlying this case are fairly straightforward. On September 4, 1980, debtor White Farm Equipment Corporation (WFE I) petitioned for a voluntary reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* On May 12, 1981, the IRS filed a claim for over $300,000 in withholding and FICA taxes—termed "trust fund taxes" because employers must hold them in trust for the United States. Trust fund taxes are entitled to seventh priority under 11 U.S.C. § 507(a)(7). The first amended plan of reorganization was confirmed on October 31, 1981. The plan contemplated that the reorganized debtor (WFE II) would continue to operate the debtor's business. The plan also promised that the IRS' priority claim for trust fund taxes would be fully repaid over a six-year period in equal annual installments.[1]

Apparently very little, if any, of the IRS' tax claim was actually paid subsequent to reorganization. On May 20, 1985, an involuntary petition to liquidate the reorganized debtor, WFE II, was brought under Chapter 7, 11 U.S.C. § 701 *et seq.* This proceeding was converted into a voluntary Chapter 11 liquidation case approximately one month later.

On September 17, 1986, the IRS filed a claim for the remaining trust fund taxes due to it under the WFE I

[1] The first amended plan of reorganization guaranteed that "[a]ll claims of government units entitled to priority under [§ 507(a)(7)] shall receive deferred cash payments over a six-year period in equal annual installments commencing 90 days after confirmation of the Plan in accordance with the provisions of § 1129(a)(9)(C) of the Bankruptcy Code."

plan. On November 5, 1987, the third amended plan of reorganization in WFE II was confirmed. A plan of liquidation, it provides that priority tax claims must be paid in full. The IRS maintains that its claim for trust fund taxes in WFE II is entitled to the same priority it received in WFE I because it arises from nonpayment of taxes due in WFE I. The Official Committee of Unsecured Creditors of White Farm Equipment Corporation (the Committee), however, contends otherwise. It argues that, once a plan of reorganization has been confirmed, the corporate debtor is discharged from any debt that arose prior to confirmation of the plan under 11 U.S.C. § 1141. According to the Committee, the IRS must now stand in line along with all other creditors because its claim for trust fund taxes is just a general unsecured claim for breach of the plan of reorganization.

"Once a tax, always a tax," was the bankruptcy court's answer to this puzzling problem. *In re White Farm Equipment Co.*, 103 Bankr. 177, 181 (N.D. Ill. 1989). The bankruptcy court carefully distinguished our decision in *Jartran*, 886 F.2d 859, which held that an administrative claim was not entitled to retain its administrative priority in a second Chapter 11 proceeding. In essence, the bankruptcy court confined *Jartran* to its facts, stating: "[T]he liability for the taxes was not created by the plan, is not affected by the plan and is not terminated when the plan terminates . . . [because] these tax obligations [are] more similar to a secured lien which is intended to survive bankruptcy unaffected than to an administrative claim which is created only for the purposes of a specific bankruptcy proceeding." *In re White Farm*, 103 Bankr. at 180. Ruling that under section 507(a)(7) trust fund taxes " 'are to be given priority without any limitation upon the time when they became due,' " *id.* at 179 (quoting *Rosenow v. State of Illinois Dept. of Revenue*, 715 F.2d 277, 279 (7th Cir. 1983)), the bankruptcy court accordingly held that their priority survives a second Chapter 11 filing.

The district court reversed. Focusing only upon the language of 11 U.S.C. § 523, which provides an exception for *individual* debtors to the general rule that the confirma-

tion of a reorganization plan under section 1141 discharges all debts that arose before the date of confirmation, the district court drew the negative inference that the priority tax debt of a *corporate* debtor must be discharged by a plan of reorganization. Because we agree with the bankruptcy court that a serial Chapter 11 filing does not divest trust fund taxes of their priority, we reverse.

II.

A. *Appellate Jurisdiction*

To reach the merits of this case, we must overcome the preliminary hurdle of jurisdiction. Bankruptcy appeals, like other appeals, generally demand finality below. 28 U.S.C. § 158(d).[2] But the concept of finality operates somewhat loosely in the bankruptcy context: certain bankruptcy orders may be deemed final before the estate is entirely closed. *See Jartran*, 868 F.2d at 861 (characterizing bankruptcy appeals as possessing a "somewhat relaxed sense of finality"); *In re Fox*, 762 F.2d 54, 55-56 (7th Cir. 1985). Because the briefs inadequately dealt with the question of finality, we requested supplemental briefing with respect to jurisdiction. We conclude that appellate review is proper in this case.

Disposition of a creditor's claim in bankruptcy is "final" for the purpose of 28 U.S.C. § 158(d) " 'when the claim has been accepted and valued, even though the court has not yet established how much of the claim can be paid given other, unresolved claims.' " *Jartran*, 868 F.2d at 862 (quoting *In re Morse Elec. Co.*, 805 F.2d 262 (7th Cir.

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[2] In this circuit, appeal from an interlocutory district court decision is also available by certification of the district court under 28 U.S.C. § 1292(b). *See In re Moens*, 800 F.2d 173, 177 (7th Cir. 1986). The circuits have, however, expressed general disagreement over this issue, *see Capitol Credit Plan of Tenn., Inc. v. Shaffer*, 912 F.2d 749, 752-54 (4th Cir. 1990), and at least one circuit has recently held section 1292(b) review unavailable in the bankruptcy context, *Germain v. Connecticut Nat'l Bank*, 926 F.2d 191 (2d Cir. 1991).

1986)). In *Jartran*, we held not final an order denying a creditor's request for administrative priority and for dismissal of a second Chapter 11 petition only because " 'a considerable number of potential disputes between Jartran and [the creditor] remain[ed] unresolved' and '[r]esolution of the claims [would have been] more than a mere "ministerial" matter.' " *In re Unroe*, No. 90-1523, slip op. at 3 (7th Cir. July 15, 1991) (quoting *Jartran*, 886 F.2d at 862). But this case is easily distinguished from *Jartran*, for WFE II's plan of liquidation has already been confirmed. Because neither the IRS' claim nor its amount are in dispute, a decision upon the priority of the IRS' claim for trust fund taxes would leave nothing further to be resolved. All that would remain is the purely ministerial task of distribution of the estate's assets in accordance with the terms of the plan.

B. *Priority of IRS' Tax Claim in Second Chapter 11 Petition*

To resolve the central question at issue here, we cautiously venture into hitherto uncharted terrain. For, as we observed in *Jartran*, Congress never anticipated the possibility of serial Chapter 11 filings: "[T]he [Bankruptcy] Code, legislative history and commentators to date simply do not consider the possibility of a situation in which a completely new liquidating Chapter 11 case could be used to deal with problems that arise in the course of consummation of a prior Chapter 11 plan." *Jartran*, 886 F.2d at 869 n.12. Instead, conversion to Chapter 7 or liquidation within the existing Chapter 11 case comprised the entire universe of options that were ordinarily contemplated when a Chapter 11 reorganization failed. *See id.* at 866. Because Congress did not contemplate serial Chapter 11 filings, it never directly addressed the question we confront here—whether the priority given a claim for trust fund taxes survives a serial Chapter 11 petition. Serial Chapter 11 filings pose novel and unprecedented problems. We must, therefore, construe the relevant statutes with care, striving to further rather than frustrate the underlying congressional objectives.

The priority and discharge provisions of the Bankruptcy Code interact in the following manner. 11 U.S.C. § 507 enumerates the priorities that are attached to various types of debts. It accords seventh priority to trust fund taxes, taxes "required to be collected or withheld and for which the debtor is liable in whatever capacity."[3] Unlike other sorts of tax claims, which are given priority under § 507(a)(7) for only a limited time, trust fund tax claims are, moreover, granted priority under § 507(a)(7)(C) regardless of their age. *See Rosenow v. State of Illinois Dept. of Revenue*, 715 F.2d 277, 279 (7th Cir. 1983) (trust fund taxes must be "given priority without any limitation upon the time when they became due"). 11 U.S.C. § 1141 elaborates upon the effect of confirmation of a reorganization plan. It specifies that, except as provided in the plan itself or by statute, confirmation of a plan of reorganization frees the debtor of all debts but those provided for in the plan.[4] 11 U.S.C. § 523, however, sets forth one exception to this general rule: it provides that con-

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[3] Section 507 provides in relevant part:

> Section 507. Priorities.
>
> (a) The following expenses and claims have priority in the following order:
>
> . . . . .
>
> (7) Seventh, allowed unsecured claims of governmental units; only to the extent that such claims are for—
>
> . . . . .
>
> (C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity . . . .

[4] Sections 1141(d)(1) and (2) provide in relevant part:

> (d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—
>
> (A) discharges the debtor from any debt that arose before the date of such confirmation . . . .
>
> (d)(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

firmation of a reorganization plan does not discharge individual debtors from certain debts for which corporations and partnerships are discharged under section 1141.[5]

Emphasizing section 523's exception to the discharge of *individual* debtors, the Committee urges us to conclude that a plan of reorganization discharges *corporate* debtors from all debts that arose prior to confirmation. The Committee maintains that, under section 1141, a confirmed plan of reorganization replaces all pre-existing debts and their priorities with whatever contractual obligations are embodied in the plan.

Yet such a drastic impairment of the scheme of priorities established in section 507 is not compelled by either the plain language of these statutes or the legislative history. For, as the IRS points out, section 523 may also be construed as prohibiting discharge of individual debtors only for *hidden liabilities*—debts not included in the plan of reorganization because no proof of claim was ever filed. This interpretation maintains the delicate balance between priority and discharge that is erected by all three statutes. It is also entirely consistent with the legislative history.

In enacting the Bankruptcy Code, Congress acknowledged the existence of a "three-way tension" among the general creditors' interest in recouping their investment, the debtor's interest in a fresh start unburdened by massive past taxes and the tax collector's interest in raising revenue. *See* S. Rep. No. 95-989, 95th Cong., 2d Sess. 14 (1978), *reprinted in* U.S. Code Cong. & Admin. News

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[5] Section 523 provides in pertinent part as follows:

Section 523. Exceptions to discharge.

(a) A discharge under . . . section 1141 . . . of this title does not discharge an individual debtor from any debt—

(1) for a tax . . .

(A) of the kind and for the period specified in . . . section 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed . . . .

5787, 5800. The Bankruptcy Code strikes a balance, accommodating these competing interests by guaranteeing priority to certain tax claims properly included in the plan of reorganization while simultaneously setting limits upon how far back in time the IRS can reach and how quickly it must act before a tax obligation loses its priority or is discharged. The legislative history also indicates that Congress sought to encourage successful reorganization by allowing debtors to present their creditors with a fixed list of liabilities:

> It is necessary for a corporation or partnership undergoing reorganization to be able to present its creditors with a fixed list of liabilities upon which the creditors or third parties can make intelligible decisions. Retaining an exception for discharge with respect to nondischargeable taxes would leave an undesirable uncertainty surrounding reorganization that is unacceptable.

124 Cong. Rec. H11089 (daily ed. Sept. 28, 1978) (statement of Congressman Donald Edwards), *reprinted in* 1978 U.S. Code Cong. & Admin. News 6436, 6478. Section 1141 fulfills this function by discharging a corporation's hidden liabilities and thereby ensuring that creditors may rely upon the plan of reorganization as representing a fixed list of liabilities.

The Committee contends, however, that only its interpretation of this network of statutes avoids the "undesirable uncertainty" that would hamper reorganization and dissuade creditors from taking the risk of dealing with a reorganized debtor. But hidden liabilities not included in the confirmed plan of reorganization are exactly the sort of claims that, if not discharged by a confirmed plan of reorganization, would promote uncertainty. Preserving intact the section 507 priorities of all tax debts that are specifically included in a confirmed plan of reorganization does not, on the other hand, create "undesirable uncertainty."

Turning finally to our decision in *Jartran*, the Committee asserts that WFE II, the second Chapter 11 proceed-

ing, is a new and distinct undertaking with new and distinct obligations. The Committee maintains that, under *Jartran*, the provisions of a confirmed plan discharge the debtor's underlying obligations and create a wholly new contract to fulfill the plan. By this reasoning, all debts incorporated in the reorganization plan lose their old priority status and are instead transformed into mere contractual obligations. But the Committee relies upon the broad language of the bankruptcy court's decision in *Jartran* to the exclusion of its narrow holding. Although the bankruptcy court expansively stated that "[t]he provisions of a confirmed plan bind all parties whose rights are affected by the plan. . . . When, as here, substantial operations under a confirmed plan are followed by a second case, the entity's unpaid liabilities under the first case plan become general unsecured claims in the second case," *In re Jartran, Inc.*, 76 Bankr. 123, 125 (N.D. Ill. 1987), it held only that administrative claims arising from expenses incurred solely to preserve the first estate were not entitled to administrative priority in a second bankruptcy proceeding. As the Committee concedes, administrative claims are intimately tied to a single bankruptcy estate in a manner that is completely different from the trust fund tax claims at issue here. Absent a clear signal from Congress, therefore, we are reluctant to adopt the Committee's broad reading of *Jartran* and extend its holding so far beyond its unique facts.

Contrary to the suggestions of the Committee, moreover, nothing in our opinion holds that all claims included in a confirmed plan of reorganization will retain their priorities forever. For claims accorded limited priority under section 507 may still lose their priority once they have become "stale." Pre-bankruptcy income taxes, for example, are allotted seventh priority only if the return to which they relate was due within three years before the petition for relief is filed. If three years have elapsed by the time the second Chapter 11 proceeding is filed, such a claim would lose its section 507 priority. Our reading of the statute neither extends nor extinguishes the

priority accorded claims under section 507. We merely strive to interpret these statutes so as to ensure that the delicate balance of the priority and discharge scheme established by the Code is not skewed by the unanticipated development of serial Chapter 11 filings.

III.

By holding that nothing in the Bankruptcy Code precludes serial Chapter 11 filings, we embarked upon this uncharted course. The bankruptcy court interpreted statutory provisions enacted without the possibility of serial Chapter 11 filings in mind in a manner true to underlying bankruptcy policies. Because the district court's decision that trust fund tax claims are stripped of their priority in a serial Chapter 11 proceeding disregards the careful accommodation of interests embodied in the Bankruptcy Code and is compelled by neither the statutory language nor the legislative history, we REVERSE and REMAND for further proceedings consistent with this opinion.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT — WITH ORAL ARGUMENT

Date: September 17, 1991

BEFORE: Honorable William J. Bauer, Chief Judge
Honorable Harlington Wood, Jr., Circuit Judge
Honorable Richard D. Cudahy, Circuit Judge

No. 90-1537

IN THE MATTER OF:

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF WHITE FARM EQUIPMENT COMPANY,

Debtor

APPEAL OF: INTERNAL REVENUE SERVICE

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division
No. 89 C 7489, Judge Harry D. Leinenweber

This cause was heard on the record from the above mentioned district court, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, and REMANDED for further proceedings, in accordance with the opinion of this Court filed this date.

APPENDIX B

[111 B.R. 162 (N.D. Ill. 1990)]

OFFICIAL COMMITTEE OF the UNSECURED CREDITORS OF WHITE FARM EQUIPMENT COMPANY, Plaintiff/Appellant,

v.

UNITED STATES of America, Defendant/Appellee.

No. 89 C 7489.

United States District Court, N.D. Illinois, E.D.

Feb. 20, 1990.

* * * * * * *

AMENDED MEMORANDUM OPINION AND ORDER

LEINENWEBER, District Judge.

This bankruptcy appeal seeks resolution of the question of whether priority status granted under 11 U.S.C. § 507(a)(7)(C) survives a serial Chapter 11 (11 U.S.C. § 1101 *et seq.*) filing where the initial Chapter 11 proceeding ended in a confirmed plan that included the priority debt. The Appellant ("the Committee") contends that it does not and the Appellee ("IRS") contends that it does.

Specifically at issue is whether the IRS' priority claim for withholding taxes for certain quarters in the tax year 1980 plus accrued interest owed by the debtor, White Farm Equipment Company ("WFE"), which was listed in the original plan of reorganization, is entitled to statutory priority in a subsequent Chapter 11 proceeding.

FACTS

On September 4, 1980 WFE filed a voluntary petition for reorganization under Chapter 11. On May 12, 1981 the IRS filed a Proof of Claim for withholding the FICA taxes pursuant to Section 507(a)(6) (since renumbered to Section 507(a)(7)).

Section 507 provides in pertinent part as follows:

> "Section 507 Priorities
>
> (a) The following . . . claims have priority in the following order
>
> * * * * *
>
> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—
>
> * * * * *
>
> (C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;"
>
> * * * * *

On October 31, 1981 the first amended Plan of Reorganization was confirmed. The plan contemplated the continued operation of the business of the Debtor by the reorganized Debtor and provided that "[a]ll claims of governmental units entitled to priority under [Section 507(a)(7)] shall receive deferred cash payments over a six-year period in equal annual installments commencing 90 days after confirmation of the Plan in accordance with the provisions of Sec. 1129(a)(9)(C) of the Bankruptcy Code."

Section 1129(a)(9)(C) provides in pertinent part as follows:

> "Section 1129. Confirmation of plan
>
> (a) The court shall confirm a plan only if all of the following requirements are met:
>
> * * * * *

> (9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—
>
> * * * * *
>
> (C) with respect to a claim of a kind specified in Section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value as of the effective date of the plan, equal to the allowed amount of such claim."

Apparently very little, if any, of the claim of the IRS was paid subsequent to the reorganization. On May 20, 1985 an involuntary petition under Chapter 7 (11 U.S.C. § 701 *et seq.*) was filed against the reorganized Debtor ("WFE II"). This proceeding was converted into a voluntary Chapter 11 case on June 14, 1985.

On September 17, 1986 the IRS filed the instant claim for the remaining taxes due it under the original Reorganization Plan of October 31, 1981. The IRS contends that its current claim is entitled to Section 507(a)(7) priority status in the current Chapter 11 case. The Committee filed an objection contending that the claim of the IRS is no longer entitled to priority status but must be treated as a general unsecured claim.

The theory of the Committee is that once a plan of reorganization is confirmed a corporate debtor such as WFE is discharged from any debt that arose before the date of confirmation by operation of Section 1141 and the claim of the IRS arose before October 31, 1981, the date the first amended Reorganization Plan was confirmed. Therefore the current claim of the IRS arises from the Plan of Reorganization rather than a Section 507, seventh priority, and as such does not receive priority.

The pertinent provisions of Section 1141 are as follows:

"Section 1141. Effect of confirmation.

* * * * *

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan

(A) discharges the debtor from any debit that arose before the date of such confirmation . . .

* * * * *

(2) The confirmation of a plan does not discharge an *individual* debtor from any debt excepted from discharge under Section 523 of this title." (emphasis supplied)

The pertinent provisions of Section 523 are as follows:

"Section 523. Exceptions to discharge.

(a) A discharge under . . . Section 1141 . . . of this title does not *discharge* an individual debtor from any debt—

(1) for a tax . . .

(A) of the kind and for the period specified in . . . Section 507(a)(7) of this title . . ." (emphasis supplied)

The IRS makes two responses to all of this. First, citing *Rosenow v. State of Ill. Dept. of Revenue*, 715 F.2d 277 (7th Cir. 1983), the IRS contends that Section 507(a)(7)(C) gives a priority to a claim for withholding taxes which can never be discharged. Second, it contends that since the Plan of Reorganization by statutory requirement (Section 1129(a)(9)(C)) provided for full payment of its claim, Section 1141(d)(1) does not operate as a discharge.

The Bankruptcy Judge sided with the IRS essentially holding that by its plain wording Section 507(a)(7) makes certain types of taxes, such as the ones involved here,

"a priority without any limitation upon the time when they become due." *In re White Farm Equipment Co.*, 103 B.R. 177 (Bankr. N.D. Ill. 1989), quoting *Rosenow*, 715 F.2d at 279.[1]

DISCUSSION

The Bankruptcy Code shows that the drafters intended to treat individual and corporate debtors differently with respect to discharge of past due taxes. Section 507 indisputedly gives the IRS a priority claim for unpaid withholding taxes owed by either an individual or corporate debtor. Although Section 523 makes certain debts, including withholding taxes, non-dischargeable its provisions apply only to individual debtors. *Yamaha Mtr. Corp. v. Shadco, Inc.*, 762 F.2d 668 (8th Cir. 1985); *In re White Farm Equipment Co.*, at 179 n. 2.

The Bankruptcy Judge however felt that Section 523 was irrelevant because the question was one of time limitations rather than dischargeability. *Id.* This interpretation however seems to render Section 523 a nullity: if a tax claim can never lose its priority under Section 523 then it would not be necessary by statute to make it non-dischargeable. Stated another way, if the drafters thought that the IRS would never lose its priority over an unpaid tax claim because of the provisions of Section 507, then it would not be necessary to prohibit discharge to individual debtors.

Further, since Section 507 gives the IRS a priority for taxes owed by both individual and corporate debtors and

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[1] However *Rosenow* involved only individual debtors. 715 F.2d at 279.

Section 523 specifically provides that only individual debtors may not be discharged from tax debts by a Section 1141 Plan of Reorganization (*Matter of Cash Currency Exchanges, Inc.*, 762 F.2d 542, 552 (7th Cir. 1985), *cert. denied, Fryzel v. Cash Currency Exchange, Inc.*, 474 U.S. 904, 106 S.Ct. 233, 88 L.Ed.2d 232 (1985)), normal rules of statutory construction require a strong inference that a Section 1141 Plan of Reorganization may therefore discharge a corporate debtor from such a priority debt. The inference that corporate debtors could be discharged from priority debts is particularly strong, here because Section 1141(d)(1)(A) provides generally for discharge of corporate and individual debtors of any debt that arose prior to plan confirmation. Section 1141(d)(2) on the other hand prohibits discharge of an individual debtor from any debt excepted from discharge under Section 523.

The actual legislative history of the Bankruptcy Reform Act of 1978 demonstrates that what is inferred above is what was actually intended by Congress. The Act itself resulted from a House Bill that was passed, in lieu of a Senate Bill, after it was amended to contain much, but not all, of the text of the Senate Bill. *U.S. Code Cong. & Admin. News 1978*, p. 5787.

In the original House version Section 1141 provided generally as it did in the final version: corporate debtors would receive general discharges from a reorganization plan and, by Section 1141(d)(2), the general exceptions to discharge contained in Section 523 were made applicable only to individual taxpayers. *Id.* at p. 6374. Subsequent to preliminary House action on the bill the Senate amended Section 1141(d)(2) so as to make it "clear what taxes remain nondischargeable in the case of a *corporate debtor* emerging from a reorganization under Chapter 11." (emphasis supplied) *Id.* at p. 5915. Among taxes specified as

non-dischargeable were "priority taxes" named in Section 507. The final version adopted was however the House version. The reasons for Congress doing so were enunciated by Congressman Donald Edwards in a statement he made at the time the final House amendment to the Senate amendment was introduced.

> "Section 1141(d) of the House amendment is derived from a comparable provision contained in the Senate amendment. However section 1141(d)(2) of the House amendment is derived from the House bill as preferable to the Senate amendment. It is necessary for a corporation or a partnership undergoing reorganization to be able to present its creditors with a fixed list of liabilities upon which the creditors or third parties can make intelligible decisions. *Retaining an exception for discharge with respect to nondischargeable taxes would leave an undesirable uncertainty surrounding reorganization that is unacceptable.*" (emphasis supplied)

Id., pp. 6436, 6478.[2]

The final argument of the IRS is that since the plan required full payment of priority taxes, it "preserved" rather than discharged the tax liability. This argument however flies in the face of the plain reading of the statute and its legislative history outlined above.

Since the liabilities created by the Plan of Reorganization are a new undertaking, the Bankruptcy Judge's own reasoning in *In re Jartran, Inc.*, 71 B.R. 938 (Bankr. N.D. Ill. 1987), *aff'd*, 87 B.R. 525 (N.D. Ill. 1988) and *In re Jar-*

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[2] There is, of course, a sound reason for treating corporate and individual taxpayers differently. If the corporation does not pay the taxes, the IRS has the option of collecting the tax from the individual who has actual control over payment of wages. 26 U.S.C. § 3401.

tran, Inc., 76 B.R. 123 (Bankr. N.D. Ill. 1987) is appropriate:

> "The provisions of a confirmed plan bind all parties whose rights are affected by the plan . . . when, as here, substantial operations under a confirmed plan are followed by a second case, the entity's unpaid liabilities under the first case plan become general unsecured claims in the second case."

In re Jartran, Inc., 76 B.R. at 125.

CONCLUSION

Accordingly, the decision of the Bankruptcy Court affording priority status to Claim No. 1-17 of the IRS is reversed and the court holds that Claim No. 1-17 is an unsecured claim of the debtor in the current Chapter 11 proceeding.

IT IS SO ORDERED.

APPENDIX C

[103 B.R. 177 (Bkrtcy. N.D. Ill. 1989)]

In re WHITE FARM EQUIPMENT COMPANY, Debtor.

Bankruptcy No. 85 B 7532.

United States Bankruptcy Court,
N.D. Illinois, E.D.

July 11, 1989.

* * * * *

MEMORANDUM OPINION AND ORDER

JOHN D. SCHWARTZ, Chief Judge.

On September 4, 1980, White Farm Equipment Company ("WFE I") filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code[1] in the United States Bankruptcy Court for the Northern District of Ohio. On that date, an order was entered authorizing the debtor-in-possession to pay pre-petition wages and benefits up to $2,000 per employee for wages earned within the ninety days preceding the commencement of that case. The order directing these payments did not specifically authorize or direct the debtor-in-possession to withhold and pay the withholding and FICA taxes which would ordinarily have been paid to the Internal Revenue Service (IRS) at or shortly after the time of the payment of the wages.

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[1] 11 U.S.C. § 101 *et seq.* All section references are to the Code unless otherwise noted.

On or about May 12, 1981, the IRS filed a Proof of Claim for these taxes pursuant to § 507(a)(6) (now and hereinafter referred to as § 507(a)(7)). The claim consisted of $339,921.80 for FICA and withholding and $13,493.01 for FUTA taxes together with interest and a penalty up to the filing date. Prior to confirmation of the Plan in WFE I, no payments on this claim were made by WFE I.

On October 31, 1981, the first amended Plan of reorganization of WFE I was confirmed. The Plan contemplated the continued operation of the business of the Debtor by the reorganized Debtor and provided that "[a]ll claims of government units entitled to priority under § 507(a)(6) [§ 597(a)(7)] shall receive deferred cash payments over a six-year period in equal annual installments commencing 90 days after confirmation of the Plan in accordance with the provisions of § 1129(a)(9)(C) of the Bankruptcy Code." It is not clear from the briefs before the court whether any of the amount to be paid under the Plan was paid. It is however clear that most, if not all, was never paid.

On May 20, 1985, an involuntary petition under Chapter 7 was filed against the reorganized WFE I ("WFE II") in the United States Bankruptcy Court in Kansas. This proceeding was transferred to this jurisdiction on June 5, 1985 and converted to a voluntary Chapter 11 case on June 14, 1985.

On September 17, 1986, the IRS filed Claim No. I-17 in the WFE II case for the remaining taxes due to it under the WFE I Plan. The IRS asserts that Claim No. I-17 is entitled to § 507(a)(7) priority status in the WFE II case. The WFE II Unsecured Creditors Committee ("Committee") has filed an objection to Claim No. I-17, arguing that the taxes due are not to be accorded a seventh priority under § 507(a)(7) in the WFE II case, but must be treated as general unsecured claims.

On November 5, 1987, this court entered an order confirming the Third Amended Plan in the WFE II case. This Plan is a plan of liquidation, providing that priority tax claims must be paid in full. The IRS contends that Claim No. I-17 arose from nonpayment of the taxes from the WFE I case and is therefore a priority claim in this case. The Committee contends that the taxes due from WFE I have no priority in the WFE II case.

For the sake of clarity, the court wishes to emphasize that the claim in question in the WFE II case is for the same tax obligations asserted as the claim in the WFE I case § 507(a)(7). The question before the court, therefore, is whether the tax obligations to be paid as provided under § 1129(a)(9)(C) under the WFE I Plan have retained their seventh priority from the first case to the second case or have lost that priority. A secondary question is whether the interest on the tax obligations is also to be accorded priority status in the WFE II case.

The IRS argues that the priority of the claim for these tax obligations, which it calls trust fund taxes, is never lost through the passage of time. The IRS cites the language of § 507(a)(7)(C), which provides seventh priority for "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity." The IRS contends that the language "in whatever capacity", combined with the legislative history of the sections according taxes seventh priority, must lead to the conclusion that the intervening event of a second bankruptcy filing has no effect on that priority in the second case. In other words, if the obligor is obligated in any possible capacity, it remains obligated through reorganization.

The Committee argues that seventh priority has never been applied in back-to-back Chapter 11 cases. The Committee reads the words "in whatever capacity" as limited to an attempt on the part of Congress to reach through the bankrupt corporation to the officers who had had responsibility for the collection of these taxes. The Committee urges the court to regard WFE II as not a continuation or repetition of WFE I, but as a new case with a new debtor and different objectives. As such, the Committee contends, WFE II was not bound to fulfill the WFE I Plan of reorganization except to the extent that the Plan bound all holders of claims. In other words, the WFE I Plan was a contract with all holders of claims, including the IRS, and the failure to perform this obligation to the IRS under the Plan was no more than a breach of that contract. Thus the IRS can make only a general unsecured claim for breach of the obligation in the WFE II case.

Neither party has brought to the court's attention any authority or legislative history directly on point and the court has found none. The court is aware of its own precedent in *In re Jartran, Inc.*, 71 B.R. 938 (Bankr. N.D. Ill. 1987), aff'd, 87 B.R. 525 (N.D. Ill. 1988) and *In re Jartran, Inc.*, 76 B.R. 123 (Bkrtcy. N.D. Ill. 1987). That case involved a situation similar to this in that a claim from a preceding case arose in a subsequent case. The argument was made, and rejected by this court, that the claim should retain its priority in the second case. In the first case, the court said:

> . . . the court does not consider Jartran II as a continuation of Jartran I, but considers the two as separate cases characterized by different objectives, assets and claims . . . *In re Jartran, Inc.*, 71 B.R. at 941.

In the second case, the court said:

> The provisions of a confirmed plan bind all parties whose rights are affected by the plan . . . When, as here, substantial operations under a confirmed plan are followed by a second case, the entity's unpaid liabilities under the first case plan become general unsecured claims in the second case. *In re Jartran, Inc.*, 76 B.R. at 125.

An administrative claim from the first bankruptcy was not allowed to retain its administrative priority in a second bankruptcy. In the court's opinion, these decisions do not apply to the question of whether taxes lose their statutory priority in a second case. The court must decide on the basis of what Congress intended with respect to a continuing priority for taxes previously due from a predecessor entity.

The two White Farm cases are indeed separate cases with different objectives, assets and claims. That does not answer the question before the court because no contention has been made that WFE II owes the taxes as a result of its own tax obligation incurred after confirmation of the WFE I Plan. The question is whether, once a tax priority claim exists, can it be lost or does it retain its priority upon transfer to a succeeding obligor.

The court also adheres to the second statement above, that the provisions of a confirmed plan bind all parties whose rights are affected by the plan. This statement does not answer the question because the government's rights are not affected by the Plan. A plan can only be confirmed if the taxing authority will receive all of what is due to the government under the tax code unless it agrees to a different amount. The only concession made to bankruptcy is that the successor (here the reorganized debtor) may pay on a statutorily-prescribed deferred basis. *See*

§ 1129(a)(9)(C). The IRS cannot contest a plan if it meets the statutory standard of § 1129 under which the government receives the entire amount of the tax which carries the § 507(a)(7) priority, over a period of time with interest. The taxes in question are covered by § 507(a)(7)(C) and "are to be given priority without any limitation upon the time when they became due".[2] *Rosenow v. State of Illinois Dept. of Revenue*, 715 F.2d 277, 279 (7th Cir. 1983). The obligation and its priority continue past the end of the bankruptcy proceedings.

In other words, the liability for the taxes was not created by the plan, is not affected by the plan and is not terminated when the plan terminates. Where a creditor can contest a plan and his rights are affected by the plan, the debt is discharged under the terms of such plan. *See In re Sportpages Corporation*, 101 B.R. 528 (N.D. Ill. 1989), affirming such a decision of this court with respect to back-to-back bankruptcy cases. The court, however, considers these tax obligations more similar to a secured lien which is intended to survive bankruptcy unaffected than to an administrative claim which is created only for the purposes of a specific bankruptcy proceeding. *Cf., In re Tarnow*, 749 F.2d 464, 466 (7th Cir. 1984). The court therefore rejects direct application of the reasoning in the *Jartran* cases to this issue.

The Committee suggests that the correct interpretation of what appears to be broad language in the Code is in fact intended to be narrow. Section 507(a)(7)(C) prescribes seventh priority for "a tax required to be collected or

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[2] The Committee has correctly pointed out that nondischargeability of taxes under § 523 applies only to individuals. However, the court notes that the Seventh Circuit discussed the lack of time limitations separately from the nondischargeability point.

withheld and for which the debtor is liable in whatever capacity." The Committee argues that the legislative history of this section defines "whatever capacity" as relating only to the liability of those corporate officers responsible for collecting and paying the taxes on behalf of the corporation after the corporation has ceased operating as a corporation. As the court reads the legislative history of those words, this interpretation appears to be correct. S.Rep. 95-1106, p. 16, 95th Cong. 2nd Sess. (1978). *But see, In re Virtual Network Services Corp.*, 98 B.R. 343 (N.D. Ill. 1989), on the inadvisability of courts' interpreting legislative hsitory to contradict the plain words of a statute. The court regards this argument as speculative rather than as a basis for its decision.

The Senate Committee apparently regarded this interpretation of the words "whatever capacity" as mandated by the Supreme Court in *U.S. v. Sotelo*, 436 U.S. 268, 98 S.Ct. 1795, 56 L.Ed.2d 275 (1978). In *Sotelo*, the Court held that a corporate officer responsible for collection of taxes on wages was liable for those taxes personally after the corporation filed for bankruptcy. Another corporate officer not responsible for collecting the tax was not liable. The decision states that the Court's purpose was to avoid a discrepancy in responsibility between sole proprietors and corporate officers, not to make any later owner of the corporation responsible for the corporation's taxes. The origin of the legislative use of the words "in whatever capacity", therefore, does not answer the question.

In describing the tax provisions of the Bankruptcy Code, Sen. DeConcini referred to a three-way tension between general creditors whose interest should not be diminished by excessive accumulations of the past due taxes, the debtor's interest in its fresh start, and the tax collector who should not lose taxes he has not had reasonable time

to collect. The Code was intended to balance these interests by (1) limiting the periods for and during which the IRS could make its claims, and (2) coordinating priority and nondischargeability provisions on the claims which would be allowed so that priority tax claims were to remain nondischargeable until the amount due as tax was collected.

> In general, the bill retains two important priority rules of present law: first that priority and nondischarge are recognized for tax claims . . . and for withheld income taxes and the employee's share of social security taxes (the "trust fund" taxes) receive priority and are nondischargeable regardless of the due date of the return.
>
> Report of Sen. DeConcini, S.Rep. 95-989, 95th Cong. 2d Sess., p. 14 (1978) U.S. Code Cong. & Admin. News 1978, pp. 5787, 5800.

The court reads this explanation as establishing two equal and coordinated rules: both priority and nondischargeability to survive bankruptcy. The purpose of both is to insure the collection of "taxes due and owing to the government in order to prevent loss of revenues to the United States Treasury." *In the Matter of Avildsen Tools & Machine, Inc.*, 794 F.2d 1248, 1254 n. 10 (7th Cir. 1986).

The concessions made to the general creditors are limited to how far back in time the IRS can reach and how quickly the IRS is required to act. These restrictions do not apply to this tax claim because the claim was timely when filed in the WFE I case. The taxes in question are trust fund taxes and therefore the claim can not lose its timeliness due to delay in payment. S.Rep. 95-989, at 14. The obligation to pay the trust fund taxes arose as a liability at the time the wages were paid and "receive priority and are nondischargeable regardless of the due date

of the return." *Otte v. United States*, 419 U.S. 43, 55, 95 S.Ct. 247, 255, 42 L.Ed.2d 212 (1974).

The court sees nothing in the Bankruptcy Code or in its legislative history which should be read to permit any intervening event to disturb this articulated balancing of interests. Under the Bankruptcy Code, therefore, the court believes that once the tax priority arose, as of WFE I's payment of wages, no later event, other than the Government's consent, could have the effect of changing that priority.

If the Code is not enough, the court is further of the opinion that the same result can be supported by a two-step analysis. The first question is whether the priority of the taxes charged as a result of being made part of the WFE I Plan, and, second, whether the tax priority changed as a result of the assumption of the taxes as a liability by the reorganized corporation. The answer to the first is a matter of bankruptcy law; the answer to the second is a matter of tax law.

Under bankruptcy law, the WFE I Plan could not have been confirmed unless the obligor under the Plan was required to pay the entire tax claim as provided in § 1129 (a)(9)(C). The obligor under the WFE I Plan was the reorganized corporation, WFE II. WFE II remained obligated to pay the tax claim which never lost its tax priority. Once a tax, always a tax.

Under tax law, WFE II stepped into the shoes of WFE I. A reorganized corporation after bankruptcy is like a successor corporation which receives the assets and assumes the liabilities of the predecessor corporation. As a general rule, a predecessor corporation which transfers its assets to another corporation and agrees to assume the predecessor corporation's debts becomes liable for those debts

under transferee liability rules. Mertens, Law of Federal Income Taxation, § 53.18. *See,* for example, *Vulcan Materials Co. v. United States,* 446 F.2d 690, 698-99 (5th Cir. 1971). "Transferee liability subjects the property in the hands of the transferee to the debts of the transferor." Mertens, at § 53.07. The liability of a transferee is assessed in the same manner as the liability of the original taxpayer. Mertens, at § 53.06; *Phillips v. Commissioner,* 283 U.S. 589, 592, 51 S.Ct. 608, 609, 75 L.Ed. 1289 (1931). If WFE I was liable for a seventh priority tax claim, then WFE II acquired that exact obligation. When WFE II filed for bankruptcy protection the tax claim it had received from WFE I retained the same priority it had been assigned in the WFE I Plan. A tax is like Gertrude Stein's rose.

The parties before the court have not argued the issue of whether interest on the tax obligation should have accrued, how long it should accrue or at what rate, or what priority it should have in the WFE II case. Because it is a substantial part of this claim and because the court must decide this issue, the court will draw the parties' attention to it.

Interest runs from the date the taxes in question should have been paid or deposited to the date of the commencement of the WFE II case on May 20, 1985.

The IRS was to receive interest on tax payments which were deferred pursuant to § 1129(a)(9)(C). *Matter of Southern States Motor Inns, Inc.,* 709 F.2d 647, 651 (11th Cir. 1983); *In re Arrow Air, Inc.,* 101 B.R. 332 (S.D. Fla. 1989). Neither the Plan nor the order confirming the Plan specified the rate of interest. Courts have interpreted § 1129 (a)(9)(C) as requiring that the rate be set so as to make

the government whole with respect to the value of its claim at the time of collection. *Id.*, at 651. The court notes that courts have used methods of calculation which refer to statutory interest rates, treasury bill rates and commercial loan rates. *Id.*, at 651. The court further notes that two recent decisions have focussed on prevailing market rates as the most sensible method to make the government whole. *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 (8th Cir. 1986); *In re Camino Real Landscape Maintenance Contractors, Inc.*, 818 F.2d 1503 (9th Cir. 1987). The parties should comment on this issue before a final order.

Interest ceased running as of the filing of the WFE II case. Interest accrued up to that point and is labelled pre-petition interest. In a recent decision, the Seventh Circuit held that pre-petition interest is matured interest which becomes part of the claim and is accorded the same priority as the underlying claim. *Matter of Roger Roy Larson*, 862 F.2d 112, 119 (7th Cir. 1988). Post-petition interest, that is, after the WFE II case commenced, is unmatured interest and is therefore not part of the claim. *Id.*, at 119.

The interest which had accrued prior to the commencement of the WFE II case, at a rate to be decided, is therefore part of the claim in the WFE II case and is to hold the same priority position as the underlying tax claim, which has held its priority as a § 507(a)(7)(C) tax claim from the date it was due and not paid.

The court sets a status on July 31, 1989 at 11:00 a.m. to determine the interest rate to be applied so that a final order may be entered.

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(2)

No. 91-997

In the Supreme Court of the United States

OCTOBER TERM, 1991

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF WHITE FARM EQUIPMENT COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether a priority claim for withholding taxes left unsatisfied after an unsuccessful corporate reorganization under Chapter 11 of the Bankruptcy Code remains entitled to priority in the debtor's subsequent Chapter 11 case.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-997

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF WHITE FARM EQUIPMENT COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-10a) is reported at 943 F. 2d 752. The opinion of the district court (Pet. App. 12a-19a) is reported at 111 Bankr. 162. The opinion of the bankruptcy court (Pet. App. 20a-30a) is reported at 103 B.R. 177.

JURISDICTION

The judgment of the court of appeals was entered on September 17, 1991. The petition for a writ of certiorari was filed on December 13, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On September 4, 1980, White Farm Equipment (WFE I) and its corporate affiliates petitioned for relief under Chapter 11 of the Bankruptcy Code. The Internal Revenue Service (IRS) filed a proof of claim for more than $300,000 for social security and withholding taxes (known as "trust fund taxes") for the third quarter of 1980.[1] At that time, Section 507(a)(6) of the Bankruptcy Code classified trust fund taxes as sixth priority obligations of the debtor. 11 U.S.C. 507(a)(6) (Supp. II 1978). In October 1981, the bankruptcy court confirmed the debtor's plan of reorganization. The plan contemplated that the reorganized debtor (WFE II) would continue operations and would pay the federal tax claim in full over a six-year period. Despite this provision for payment, the reorganized debtor (WFE II) in fact paid little, if any, of the federal tax claim (Pet. App. 2a).

2. In May 1985, an involuntary petition for liquidation of WFE II was filed under Chapter 7 of the Bankruptcy Code, and an order for relief was entered under 11 U.S.C. 303. Shortly thereafter, the proceeding was voluntarily converted by WFE II to a reorganization case under Chapter 11. In September 1986, the IRS filed a claim for the remaining unpaid trust fund taxes that were provided for in the original confirmed plan of reorganization. The IRS asserted that its tax claim in the second reorganization was entitled to the same priority that it had in the original reorganization.[2]

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[1] Trust fund taxes include federal income and social security taxes that an employer collects from its employees. 26 U.S.C. 3102, 3402. The Internal Revenue Code provides that those amounts are "a special fund in trust for the United States" that must be paid over to the government. 26 U.S.C. 7501. See *Begier* v. *Internal Revenue Service*, 110 S.Ct. 2258, 2263 (1990).

[2] In 1984, Congress amended the Bankruptcy Code to create a new category of claims that it designated as fifth priority claims. As a result of adding this new provision, which included certain

Petitioner, the Committee of Unsecured Creditors, objected to the IRS claim on the ground that it should be treated as a general unsecured claim rather than as a priority claim. In petitioner's view, confirmation of the debtor's original reorganization plan discharged *all* pre-confirmation liabilities, substituting in their place a mere contractual undertaking to pay pursuant to the terms of the plan. In petitioner's view, the IRS claim for trust fund taxes was therefore not a priority tax claim, but a general unsecured contract claim (Pet. App. 2a-3a).

3. The bankruptcy court denied petitioner's objection and held that the tax claim was entitled to seventh priority in the second bankruptcy proceeding (Pet. App. 20a-30a). The court distinguished *Fruehauf Corp.* v. *Jartran, Inc.*, 886 F. 2d 859 (7th Cir. 1989)—which held that an administrative claim in one Chapter 11 case is not entitled to retain the same priority in a succeeding Chapter 11 case—on the basis that administrative claims are created "only for the purposes of a specific bankruptcy proceeding" while obligations for trust fund taxes are in the nature of "a secured lien which is intended to survive bankruptcy unaffected" (Pet. App. 23a-25a). The court noted that Congress balanced the interest of general creditors, the taxing authorities and the debtor by allowing trust fund taxes to retain their priority regardless of age while imposing time limitations on the priority accorded certain other tax claims. The court observed that neither the statute nor its legislative history indicated that Congress intended an "intervening event," such as a second Chapter 11 filing,

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unsecured claims of individuals engaged in raising or producing grain or working as fishermen, tax claims became seventh rather than sixth priority claims. See 11 U.S.C. 507(a)(5) and (7). Because the 1984 Act was effective with respect to cases filed after October 8, 1984, the amended version of Section 507 applied to WFE's second, but not its first, bankruptcy proceeding.

to disturb this "articulated balancing of interests" (Pet. App. 28a). Since a "tax" is not converted into a contract debt by a reorganization, the priority accorded to trust fund "taxes" continues "past the end of the bankruptcy proceedings" (Pet. App. 25a, 28a-29a).

4. The district court reversed (Pet. App. 12a-19a). The court relied largely on Section 1141(d)(2) of the Bankruptcy Code which, in conjunction with Section 523, distinguishes between individual debtors and all other debtors with respect to the breadth of the discharge effected upon confirmation of a Chapter 11 plan. Under those provisions, certain specified tax debts (including trust fund tax debts) cannot be discharged in cases of individuals, even if a claim for such taxes was not filed or allowed. See 11 U.S.C. 523(a)(1)(A). The district court reasoned that the explicit exception from discharge for certain debts of an individual in Section 1141 creates a "strong inference" that those debts *were* discharged for corporations (Pet. App. 16a-17a). The court stated that "[i]f the drafters thought" that Section 507's priority provisions prevented the IRS from ever losing its priority with respect to an unpaid tax claim, "then it would not be necessary to prohibit discharge to individual debtors" (*id.* at 16a).

The district court also rejected the government's argument that its claim for trust fund taxes was not discharged because it was provided for in the original confirmed plan. Because it was not discharged, the government argued, it remained a "tax" claim and, therefore, was still entitled to priority as a "tax" claim under the plain language of Section 507(a)(7) of the Bankruptcy Code. The court stated that this argument "flies in the face" of both the legislative history and the "plain reading" of the statute (Pet. App. 18a).

5. The court of appeals reversed (Pet. App. 1a-10a). The court observed that the district court's decision was "compelled by neither the statutory language nor

the legislative history" and "disregard[ed] the careful accommodation of interests embodied in the Bankruptcy Code" (*id.* at 10a). The court noted that Congress had never directly addressed the question whether the priority given a claim for trust fund taxes survived serial Chapter 11 filings (Pet. App. 5a). Instead, the Bankruptcy Code "strikes a balance," accommodating the competing interests of the debtor, the tax-collector and general unsecured creditors by guaranteeing priority for certain tax claims, while at the same time setting limits upon how far back in time the tax collector can reach and, therefore, how quickly it must act to collect delinquent taxes (*id.* at 8a). Construing the relevant statutes in view of those congressional objectives, the court concluded that claims for trust fund taxes, which are entitled to priority without regard to age (11 U.S.C. 507(a)(7)(C)), do not lose priority upon confirmation of a reorganization plan that properly provides for their payment.

The court rejected the district court's construction of Section 1141(d). That provision states that confirmation of a reorganization plan frees the debtor of all debts, "[e]xcept as otherwise provided in this subsection, in the plan, or in the order confirming the plan." 11 U.S.C. 1141(d). The court explained that the exception from discharge provided in Section 523 for certain tax debts of individuals does not imply that all tax debts of a corporation or partnership are discharged. The function of Section 523 is to except from an individual's discharge "*hidden liabilities*—debts not included in the plan of reorganization because no proof of claim was ever filed" (Pet. App. 7a). Confirmation of a reorganization plan discharges corporate and partnership debtors of such hidden liabilities, but not of liabilities provided for in the confirmed plan (such as the trust fund tax liability involved in this case), because Congress believed it was necessary for these entities to present their creditors

with a "fixed list of liabilities" to dispel "undesirable uncertainty surrounding reorganizations" (*id.* at 8a, quoting 124 Cong. Rec. 32,408 (1978) (statement of Rep. Edwards).

Finally, the court of appeals declined to adopt the district court's broad reading of the court of appeals' earlier decision in *Freuhauf Corp.* v. *Jartran, Inc.*, *supra*. As petitioner conceded, administrative claims, unlike claims for trust fund taxes, are intimately related to a single bankruptcy estate (Pet. App. 8a-9a). The conclusion in *Jartran*—that an administrative claim incurred solely to preserve the first estate does not retain its character as an "administrative expense" in the second bankruptcy—is not applicable to "tax" claims, which retain their character as "tax" claims in both the first and second bankruptcy and are therefore entitled to priority in both reorganization proceedings (*id.* at 9a-10a).

ARGUMENT

The court of appeals correctly held that a priority claim for trust fund taxes under a confirmed plan of reorganization retains its priority if the reorganization fails and a second Chapter 11 proceeding is commenced. The decision in this case does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Section 1141(d)(1) of the Bankruptcy Code, which governs the effect of confirmation of a plan of reorganization, provides that "*except as otherwise provided * * * in the plan*, or in the order confirming the plan, the confirmation of a plan * * * discharges the debtor from any debt that arose before the date of such confirmation" (emphasis added). 11 U.S.C. 1141(d)(1). The statute thus plainly states that debts that are "provided" for in a plan of reorganization are preserved and, as a result, must be paid by the reorganized debtor. As the court of appeals recognized (Pet. App. 7a-8a), nothing in

Section 1141(d)(1) supports petitioner's claim that priority taxes that are provided for in a confirmed reorganization plan are discharged, or transmuted into a claim for "breach of contract," under the plan. Instead, what was a "tax" before confirmation is still a "tax" after confirmation. As a "tax" claim, the priority expressly provided by Section 507 remains applicable (Pet. App. 10a).[3] See 11 U.S.C. 507(a)(7).

2. Section 523 of the Bankruptcy Code in no way alters this analysis. Section 523 provides that an individual (unlike partnerships and corporations) is not discharged from specific pre-confirmation liabilities upon confirmation of a reorganization plan. From this provision concerning individuals, petitioner attempts to draw the negative inference that confirmation of a plan of reorganization must discharge a corporate debtor from *all* pre-confirmation debts (Pet. 10.)

The Bankruptcy Code and its legislative history provide no support for petitioner's position. As the court of appeals correctly recognized (Pet. App. 6a-8a), Section 523 simply prohibits a discharge for individual debtors of certain "hidden liabilities" (Pet. App. 7a) that were not included in the plan of reorganization because a proof of claim was not filed. The legislative history relied on by petitioner (Pet. 4, 10) indicates that Congress

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[3] Contrary to petitioner's argument (Pet. 8), taxes are not accorded special treatment under the court of appeals' analysis. Any claim, the priority of which is not conditioned upon its age or its special relation to the bankruptcy estate, will retain its priority in a second Chapter 11 case. For example, to the extent that the claims of farmers, fishermen and consumers are given priority under Section 507(a)(5) and (6) in the first case, their claims will be equally entitled to priority in a second case. Unlike these types of claims, whose character is not altered in the second bankruptcy, a claim for administrative expenses from the first bankruptcy is *not* an "administrative expense" of the second bankruptcy. See Pet. App. 9a.

believed similar exceptions from discharge would be unwise in the case of business entities. Congress desired to facilitate corporate and partnership reorganization by providing creditors certainty that all of the entity's liabilities are disclosed in the reorganization process. See 124 Cong. Rec. 32,350, 32,408 (1978) (statement of Rep. Edwards); *id.* at 33,989, 34,008 (statement of Sen. DeConcini). This goal is achieved by discharging any corporate debt that is *not* provided for in the plan of reorganization, for then creditors may deal with the reorganized entity without fear of hidden liabilities.

This understanding of the statute conforms with Section 1141(d)(1), which provides that, "except as otherwise provided * * * in the plan," confirmation discharges a corporate debtor from any pre-confirmation debt. 11 U.S.C. 1141(d)(1). Because liabilities included in a reorganization plan are disclosed to creditors, this interpretation of the Code is consistent with the congressional aim of enabling a reorganized entity to present its creditors with a "fixed list of liabilities" (124 Cong. Rec. 32,408 (1978) (Rep. Edwards)) upon which they may rely. As the court of appeals correctly observed (Pet. App. 8a), preserving the priority that Congress provided for disclosed tax claims does not create "undesirable uncertainty" that would impede reorganization of corporations and partnerships.

2. The decision in this case does not conflict with any decision of this Court or any other court of appeals. Petitioner errs in contending (Pet. 10-11) that the decision is in conflict with the earlier decision of the same circuit in *In re Jartran, Inc.*, 71 Bankr. 939 (Bankr. N.D. Ill. 1987), aff'd, 886 F. 2d 859 (7th Cir. 1989). The alleged intra-circuit conflict is, of course, an insufficient basis upon which to invoke certiorari jurisdiction. See *Davis* v. *United States*, 417 U.S. 333, 340 (1974). There is, in any event, no conflict. As the court of appeals observed

(Pet. App. 9a), *Jartran* held only that administrative expenses incurred solely to preserve the first bankruptcy estate did not have the character of administrative expenses in the second bankruptcy and were therefore not entitled to administrative priority in the second proceeding. As petitioner concedes (Pet. App. 9a), "administrative claims are intimately tied to a single bankruptcy estate in a manner that is completely different from the trust fund tax claims at issue here." The court of appeals thus correctly refused to extend its holding in *Jartran* beyond the "unique facts" (*ibid.*) of that case. See note 3, *supra*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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